EXECUTIVE SECRETARIAT

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TO:

		ACTION	INFO	DATE	INITIAL
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13	D/EEO				
14	D/Pers				
15	D/OEA				
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17	SA/IA				
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SUSPENSE ____________ Date

Remarks:

Received CIA 1215, 7/1/82. (I have again discussed with Cabinet Office late arrival of papers.)

[redacted]

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Executive Secretary

1 July 82

Date

Give Argentina paper to OALA

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THE WHITE HOUSE
WASHINGTON

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CABINET AFFAIRS STAFFING MEMORANDUM

DDI- 5466-82

DATE: 6-29-82 NUMBER: 077347CA DUE BY:

SUBJECT: Cabinet Council on Economic Affairs -- July 1 Meeting

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
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	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☑	☐
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
Mike Wheeler	☐	☑
Larry Kudlow	☑	☐
	☐	☐
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	☐	☐
	☐	☐
CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet on Thursday, July 1, at 8:45 a.m. in the Roosevelt Room.

The agenda and papers are attached.

~~CONFIDENTIAL~~

RETURN TO: ☐ Craig L. Fuller, Assistant to the President for Cabinet Affairs ☑ Becky Norton Dunlop, Director, Office of Cabinet Affairs

THE WHITE HOUSE

WASHINGTON

June 29, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the July 1 Meeting

The agenda and papers for the Thursday, July 1 meeting of the Cabinet council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a discussion of U.S. membership in the African Development Bank. A paper, prepared by the Department of the Treasury, on this issue is attached. The paper discusses the background of U.S. involvement with the African Development Bank, the Bank's institutional and financial problems, and the budgetary implications of U.S. membership.

The second agenda item is a review of the Argentine economic situation and outlook. A paper, prepared by the Department of the Treasury, on this subject is also attached.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

July 1, 1982

8:45 a.m.

Roosevelt Room

AGENDA

1. U.S. Membership in the African Development Bank (CM#270)

2. Argentine Economic Update and Outlook (CM#179)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 29, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: MARC E. LELAND
ASSISTANT SECRETARY
INTERNATIONAL AFFAIRS

SUBJECT: U.S. Membership in the African Development Bank

The amendments to the charter of the African Development Bank (AFDB) to allow membership by non-regional countries were ratified during the Bank's annual meeting in May. It is anticipated that by December the final steps will have been taken to open formally the Bank to non-African members. Therefore, a final decision on U.S. membership in the Bank is needed. In making that decision the financial and institutional problems of the African Development Bank as well as the budgetary implications of membership should be considered. In order to provide the background for a decision on U.S. membership, a brief history of the AFDB and U.S. involvement in it is set out below. Following the history is a discussion of the problems facing the Bank and the budgetary implications of U.S. membership.

The AFDB and U.S. Involvement

The African Development Bank was established in 1964 to make loans on near-market terms for the economic and social development of its African members individually and through regional cooperation. The AFDB's concessional loan affiliate, the African Development Fund (AFDF), was formed in 1972 pursuant to an agreement between the AFDB and 16 non-regional states. The African Development Fund is a separate and distinct financial and legal entity from the African Development Bank with a separate Board of Directors. However, the management and staff are the same for both institutions. The U.S. has been a member of the AFDF since 1976 and is currently pledged to provide an annual contribution of $50 million.

The Bank currently has 50 African member countries who have subscribed to over $2.9 billion in capital and paid-in more than $740 million. The AFDB is the only pan-African institution devoted to the financing of development. In its 15 years of operations the Bank has lent over $1.6 billion, primarily for projects aimed at strengthening the agricultural sector and financing needed infrastructure.

While non-regional countries have been members of the African Development Fund since its inception, membership in the Bank has been restricted to African nations. The limited resources of the Bank's African members severely restricted the AFDB's lending programs and its access to private capital markets. Consequently, in May 1979, the Governors of the AFDB approved resolutions to allow non-regional countries to join the Bank and recommended that the African member states ratify the resolutions.

The U.S. actively participated in the negotiations leading to the decision of the AFDB Governors to open the Bank and secured for itself the largest share of the proposed non-regional portion of AFDB capital stock. In 1979 the U.S. agreed, subject to Congressional approval, to join the Bank. As part of the preparation for U.S. entry into the Bank, Treasury conducted a thorough analysis of the AFDB's financial situation. At that time (late 1979), the Bank had just begun to borrow heavily at floating rates to finance its operations. Treasury was concerned about the large negative spread between the AFDB's lending rate and marginal borrowing costs and conveyed these concerns to Bank Management and other prospective had just begun to borrow heavily at floating rates to finance its non-regional members. The other non-regionals shared the concerns but felt that this was precisely why non-regional membership (and non-regional paid-in capital) was needed. The Bank acted to reduce the current cost of the negative spread by limiting actual borrowings and arranging instead for lines of credit. Although the lines of credit carried floating rates, the Bank hoped that they would be able to replace them with lower, fixed rate borrowings before the credit lines had to be drawn on.

In early 1981, believing that ratification by the African member states of the charter amendments allowing non-regional membership was imminent, the Reagan Administration sought and obtained the necessary legislation for the U.S. to join the AFDB. Authorization for U.S. membership with a subscription of $360 million over five years (17 percent of total non-regional subscriptions) was included in the FY 1982 Budget Reconciliation Bill. The first installment of the U.S. subscription to the AFDB (an appropriation of $18 million of paid-in capital and a program limitation of $54 million for callable capital) was included in the FY 1981 Supplemental Appropriations Bill.

After the legislation had been enacted it became clear that non-regional membership would not occur immediately. Algeria, Libya and Nigeria refused to ratify the necessary changes in the Bank's charter. After a concerted effort by the Bank and most of its members, Nigeria was finally persuaded to change its position and, in May of this year, ratified the charter amendments.

Now that the AFDB charter has been changed to allow non-African members, the increase in capital needs to be triggered so that there are shares of AFDB stock for the non-regionals to subscribe. It is anticipated that this will occur in the last quarter of this year so that non-regional members can formally join the Bank by late 1982 or early 1983. All the other non-regional countries either are ready or expect to be ready to join the AFDB by December. Nearly all the non-regionals have expressed a willingness to join the AFDB as soon as the Bank is formally open to them.

AFDB's Institutional Problems

From an administrative and operational viewpoint, the African Development Bank Group is less effective and efficient than the other multilateral development banks. This is not surprising given the relatively low salaries paid the staff of the AFDB and the fact that the staff is drawn entirely from regional member countries -- the Bank simply does not have the access to the highly trained, experienced manpower the other MDBs do. AFDB Management is aware of the administrative and operational weakness of the Bank and has been taking measures to strengthen the institution and its staff. However, substantial further improvement will be needed in the AFDB. It is anticipated that hiring of non-regional staff members will help raise the level of staff expertise and full non-regional participation in AFDB policy making will result in changes which will foster administrative improvements.

AFDB's Financial Problems

The financial condition of the Bank has deteriorated since Treasury first began to monitor the situation two years ago. The single most important factor in the decline has been the lack of Bank action to increase lending rates. This has been compounded by increasing loan and subscription arrearages and poor performance in the Bank's investment account. The biggest problem is that the AFDB is committed to funding about $930 million in loan commitments carrying interest rates of 8 to 8.5 percent while it would currently have to draw on lines of credit bearing interest rates of 18-19 percent to do so.

The greatest concern is that if present trends continued, it is possible to imagine that an actual call on callable capital could become necessary. Fortunately, Management has acknowledged the difficult financial future facing the Bank and proposed steps that, if fully implemented, would begin to stem the deterioration in the AFDB's financial condition. The Board of Directors has agreed to adopt Management's proposals for financial policy changes, and has increased the effective rate of interest on most loans to 10.5 percent. Management has moved to collect both loan and subscription arrearages. While these actions are a good first step, further changes will be needed to put the Bank on a sound financial footing.

Budgetary Implications of U.S. Membership

When the opening of the AFDB to membership by non-regional countries was delayed, it was decided that funds for the Bank would not be requested for FY 1983 and no provision would be made for subscriptions in the out-years. No decision was made to request rescission of the amounts already appropriated.

An affirmative decision on U.S. membership in the AFDB would require that an appropriation be requested in FY 1984 and that AFDB subscriptions be provided for in the budget planning levels for FY 1985 through FY 1987. Membership would entail budget outlays totaling $90 million; $18 million per year over the FY 1983-87 period. Annual requests would be $18 million for paid-in capital and $54 million in program limitations for callable capital subscriptions in fiscal years 1984-87.

The budgetary costs of membership will be modest although it can be argued that even those amounts will be difficult given current budgetary circumstances. As far as the AFDB's financial situation is concerned, the situation is serious,but shows positive signs. The AFDB has already started to take steps to improve the Bank's financial condition and non-regional membership can only result in further positive action on both financial and administrative fronts.

As a member of the AFDB the U.S. could effect necessary policy and administrative changes that we cannot do as a member of only the AFDF. Membership in the Bank, i.e., the "hard loan window" of the institution, could be seen as a natural corollary to our participation in the "soft loan window", the African Development Fund. In addition, membership in the Bank would be consistent with the MDB Assessment conclusions in that AFDB lending is concentrated on poor countries.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUN 29 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: MARC E. LELAND
ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

SUBJECT: Argentine Economic Update and Outlook

1. Overview.

Argentina's economy faces severe external constraints in the months ahead. Reserves — currently estimated at $1 billion excluding gold — are expected to decline further during the August/November period as agricultural exports suffer normal seasonal lows. The new government's economic policies are expected to reflect a greater willingness to use government intervention in the economy in response to populist pressure. This will not help Argentina's creditworthiness with foreign banks. Although many creditors--particularly the larger commercial banks — continue to roll over maturing Argentine debts into new short-term obligations, a significant number of smaller institutions have reduced their exposure in Argentina. The GOA will probably seek a major restructuring of its commercial debt in the months ahead through a consolidation of short-term public sector obligations into a "jumbo" syndication led by major U.S. banks. While the GOA does not wish to seek an IMF standby due to internal political considerations, such a move may prove necessary to avoid an unacceptably low level of reserves and mounting commercial arrearages in the fourth quarter. (C)

2. Economic Situation.

- Growth and Inflation. Argentina's economy continued to contract during the first quarter of 1982 with GDP 5.6% below the first quarter 1981 pace. Inflation, which had accelerated to 130% for the 12-months ending in December 1981, will be aggravated by increased military spending and efforts to spur economic growth. Inflation may accelerate to over 200% by the end of 1982. (LOU)

- Trade and Payments. The outlook for Argentina's external accounts is not as grim as one might expect. The EC embargo of Argentine goods is only now beginning to be felt in Argentina and the impact appears to be minimal. Lower imports and continued export gains will probably permit a trade surplus of $2.5 billion this year. This will be more than offset by services outflows (mostly for interest on the foreign debt) and the current account will be in deficit by some $2.6 billion. The crucial problem in the external accounts will be access to external finance in the face of low creditor confidence. (C)

3. Debt and Debt Service.

Argentine data show that the external debt stood at $35.7 billion at the end of 1981. Of this, $14.6 billion is due in 1982, including an estimated $11.4 billion in short-term obligations. (LOU)

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Classified by ME LELAND
☐ Declassify ☒ Review for

The South Atlantic crisis cut off Argentina's access to new private medium and long-term credit, reduced the flow of new short-term credits, and appears to have eroded some of the normal roll-over of short-term credits. Argentina faces sharply higher borrowing costs and reduced overall credit access, as banks tighten country lending limits to Argentina in light of the country's diminished economic prospects and uncertain political future. (C)

Prospects of serious debt-service problems during the next six months have increased sharply. The situation should be manageable, however, unless the major banks refuse to roll over short-term credits — a development which we do not currently foresee — or unless compounded by other international debt problems unrelated to the Argentine situation. (C)

Even before the South Atlantic crisis, the GOA needed to restructure its debt. The war in the Falklands has resulted in a further accumulation of short-term debt. We expect concerted efforts later this year to refinance about $5 billion of short-term debt and current maturities of long-term debt. This will be very difficult unless the GOA demonstrates a priority commitment to economic policies designed to support the balance of payments. (C)

4. Economic Dimensions of Political Succession.

The dismissal of President Galtieri, infighting within the military forces, and the decision to hold elections in late 1983 have significant implications for Argentine economic leadership and policy. We have been informed by Argentine officials that Jose Maria Dagnino Pastore will succeed Roberto Alemann as Minister of Economy once General Bignone is sworn in on July 1. Central Bank President Ianella is to keep his current post. The new GOA team reportedly does not believe that the time is right for an IMF program. Dagnino Pastore was Minister of Economy during 1969-70. We expect that international creditor and investor reaction to Pastore's appointment will be mixed due to his lack of recent government experience and a believed openness to greater use of government intervention in the economy. Creditors will probably be reassured, however, by the continued presence of Central Bank President Ianella. (C)

5. Prospects & Problems for the Balance of 1982

Argentina's economic leaders are hoping that the prospect of elections in late 1983 will divert pressure from civilian opponents away from the economic policy front. This is probably unrealistic and we expect chronic pressure for populist, stimulative economic policies for the balance of the year. This augers ill for the GOA's ability to control government spending and limit the fiscal and monetary deficits. However, it should have only marginal immediate impact on the external accounts. Export prospects still look good and imports and other non-debt payments will continue to be subject to stringent import barriers and comprehensive exchange controls. Moreover, renewed subsidies and protection for domestic industry and exporters should further shore up the trade account, at least in the short run. A major unknown, however, will be exchange ràte policies. Even with comprehensive exchange controls, the GOA will have to keep devaluing the peso roughly in line with domestic inflation or face renewed pressure on the balance of payments through smuggled imports, lost export markets, and capital flight. (C)